

Disclosures

March • April 2009 | Vol. 22 No. 2 | www.vscpa.com



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Twist
on the
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Scheme

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The Vavasseur Prime Bank Securities Fraud

A New Twist on the Classic Ponzi Scheme

By Harold G. Martin Jr., CPA, ABV, CFF, ASA, CFE, and Roy M. Terry Jr., Esq.

On December 11, 2008, a special agent with the U.S. Bureau of Investigation filed a complaint in U.S. District Court, Southern District of New York, alleging that Bernard L. Madoff Investment Securities LLC, a firm with supposedly more than \$700 million in capital and ranking in the top 1 percent in the securities industry, had perpetrated a Ponzi scheme with losses of approximately \$50 billion.

While the Madoff case has been receiving substantial national media coverage in recent months, a similar fraud was conducted a little closer to home. ...



Mugshot of Terry Dowdell, "mastermind" of the Vavasseur fraud



The Dowdells' house in Charlottesville, Va., which was seized by the receivership and sold at auction for approximately \$1 million

From April 1998 through spring 2002, Terrence (“Terry”) Lee Dowdell, a resident of Charlottesville, Va., raised millions of dollars from investors in the United States and abroad through the sale of fictitious securities in a trading program offered by his Bahamas-based Vavas seur Corporation.

Dowdell lured investors to his program with promises of risk-free investments and 70 percent annual rates of return. While such investments may sound unbelievable to most, during the course of the fraud, Dowdell convinced investors to deposit more than \$70 million in the Vavas seur fund.

Ponzi schemes and prime bank securities frauds

The Vavas seur fraud is a form of “prime bank securities fraud,” which is a new variation of the classic “Ponzi” scheme. A Ponzi scheme is a type of illegal pyramid scheme named for Charles Ponzi, who conducted an infamous fraud in the 1920s involving speculation in international postage stamps. Such schemes are “an illegal business practice in which new investors’ money is used to make payments to earlier investors.”¹

Although the inflow of funds during the early phases of a Ponzi scheme may mislead investors into believing the investment is legitimate, the financial survival of the investment is impossible to sustain over the long run. Such schemes typically collapse when investors, during the later levels, begin to demand return of their principal, and the outflow of funds to these investors exceeds the inflow of new funds.

In the prime bank securities version of this scheme, the perpetrators typically claim that a secret trading market exists among the world’s top or prime banks. These banks trade some form of security such as bank guarantees, notes or debentures, which can be purchased at a discount and sold at par. The countless repeating of this process by participants yields returns in excess of the market with no risk.

Promoters typically tell potential investors that they have special access to a trading program and that they are one of the select few authorized to trade in these securities. Further, the promoters advise potential investors that these securities must be traded in large blocks and that the investors can participate in the program by pooling their funds with those of other investors.

*In actuality, neither this market nor these securities exist.*²

The Vavas seur fraud

In April 1998, Terry Dowdell, then a resident of Florida, formed the Vavas seur Corporation as a Bahamas-based entity and began his version of the prime bank lending scheme. In reality, Vavas seur never conducted any legitimate business. Dowdell represented to investors that Vavas seur would buy short-term \$1 million notes issued at a discount by Barclays bank in the United Kingdom. These notes represented debt issued by governments for off-balance sheet activities (e.g., covert activities). Dowdell claimed he could sell these notes at face value to buyers and the investment fund would realize the spread as profit—as much as a 70 percent annual rate of return.

Dowdell’s scheme started slowly, but gradually attracted new investors and, more importantly, “promoters” who marketed his investment scheme to other investors. While it is uncertain whether all such promoters actually believed Dowdell’s claims about the Vavas seur program, one alleged promoter who was a Chicago attorney stated he was convinced that Vavas seur was real based on his observation that one of his legal clients received promised distributions. This marketer’s belief was further based upon his reading of a letter of reference for Dowdell allegedly signed by Sir John Templeton, which indicated that Dowdell had formerly been employed as the chief financial officer for the operating companies of the Templeton funds.³

The U.S. Securities and Exchange

Commission (SEC) began an investigation of Vavas seur after being tipped off by this same attorney/marketer who was being investigated for participation in another scheme. After the SEC began its investigation, Dowdell attempted to put an end to it by purportedly transferring his interest in Vavas seur offshore to a third party and by representing to the SEC that he had repaid all U.S. investors. Dowdell then informed investors that Shindar Gangar and Alan White, principals in the U.K. accounting firm Dobb White & Co. and Dowdell’s collaborators, would be responsible for the administration of Vavas seur.

Certain U.S. investors did receive a return of their principal sometime in March 2001, but, by pre-arrangement with Vavas seur, the investors immediately reinvested by wiring their funds to various offshore bank accounts controlled by Vavas seur. Although Dowdell told the SEC that he no longer had any interest in Vavas seur, he continued to control Vavas seur through his U.K. associates, Gangar and White.

After Dowdell told the SEC that Vavas seur had repaid its investors, Dowdell stopped using the U.S.-based bank accounts that he had opened in Florida AmSouth Bank at the beginning of the fraud; however, Dowdell continued to accept investor funds into other U.S. accounts he controlled. From March 2001 to November 2001, investors continued to deposit funds into both U.S. and foreign bank accounts.

Sometime after November 2001, investors were directed to wire their investments to the Bank of Butterfield in Guernsey, Channel Islands; the Overseas Development Bank & Trust, Dominica; Investec Bank, Israel; and the Bank of Ireland. All distributions made to investors after November 2001 were made from foreign bank accounts. Dowdell’s U.K. associates, Gangar and White, had direct control over these foreign bank accounts, accepting new investments and making distributions to investors. ▽

Hot on the trail: Forensic accounting resources

For more information about Ponzi schemes, prime bank securities frauds, the Vavasseur fraud and other fraud-related matters, see the following:

Ponzi scheme

Albrecht, W. Steve, et al. "Fraud Examination," 3rd ed. Mason, Ohio: South-Western, a division of Thomson Learning, 2009.

Durkin, Ron and Tim Hedley, "Recognizing and Prosecuting Ponzi Schemes," *CPA Expert*, Spring 2004: 8–11.

Zuckoff, Mitchell. "Ponzi's Scheme." New York, NY: Random House, 2005.

Prime bank securities frauds

www.sec.gov/divisions/enforce/primebank/howtheywork.shtml

www.treasuryscams.gov/instit/statreg/fraud/fraud_primebank.htm

Vavasseur fraud

www.dowdell-receivership.com
www.sec.gov/litigation/litreleases/lr17242.htm

Maiello, Michael, "Thieves Don't Quit," *Forbes*, June 9, 2005: 150–152.

Professional organizations

American Institute of Certified Public Accountants Forensic & Valuation Services Center:

<http://fvs.aicpa.org/>

Association of Certified Fraud Examiners: www.acfe.com



As of November 19, 2001, the SEC had learned of Dowdell's continuing involvement in the fraud, and filed a civil enforcement suit against Dowdell and certain others. The U.S. District Court then froze Dowdell's U.S. bank accounts. In December 2002, a criminal injunction was filed against Dowdell for violation of the SEC Act and wire fraud. Following this action, Dowdell agreed to cooperate with the authorities in winding up the fraud (with fingers crossed).

After the SEC civil suit was filed⁴, Dowdell continued to be involved in Vavasseur; however, Gangar and White assumed more responsibility for the daily operations. In April 2002, Dowdell obtained certain Vavasseur financial records from Gangar and White, including a partial accounting of distributions made to investors from foreign bank accounts. The SEC and foreign law enforcement authorities then moved to freeze the foreign bank accounts identified from the Vavasseur financial records.

The frozen bank accounts created severe cash-flow problems for Vavasseur. To address this problem, in April 2002, Vavasseur informed its investors that monthly distributions would cease while it reorganized into an even larger program. Investors were told that after the reorganization, Vavasseur would commence a new trading program that would increase yields to in excess of 100 percent per annum.

Investors were asked to consent to the transfer of their funds to this new program,

which was also completely fictitious. Soon thereafter, the scheme collapsed, as Vavasseur did not have sufficient funds to pay distributions to investors.

Cleaning up: The receiver and forensic accountant

Following the SEC's complaint filing, the U.S. District Court established receiverships for Vavasseur and other related entities alleged to have been involved in the fraud. To oversee the administration of the receiverships, the Court appointed Roy M. Terry Jr. and the law firm of DuretteBradshaw PLC as receiver over certain of these entities on July 12, 2002, and over Vavasseur on February 18, 2003.

The receiver's responsibilities included initiating litigation to recover assets (including the frozen foreign bank accounts); liquidating personal and real property acquired with stolen funds (particularly for Dowdell and his extended family); establishing bank accounts for recovered funds; preparing a plan of distribution; assessing claims and distributing funds to investors; and preparing periodic status reports for the Court.

To assist DuretteBradshaw with the administration of the receivership, on September 12, 2002, the Court appointed Harold G. Martin Jr. and the accounting firm of Keiter, Stephens, Hurst, Gary & Shreaves, PC, as accountant.

The responsibilities of the accountant included tracing stolen funds; identifying

personal and real assets; assisting with recovery and liquidation of assets; analyzing computer records to recover evidence; seizing the assets of a business funded with stolen monies; managing the investment of recovered funds; assisting with the assessment of investor claims and distribution of funds; serving as expert witness in litigations initiated by the receiver to recover stolen funds; maintaining accounting records and preparing financial statements for the receivership; and preparing federal and state income tax returns.

Authorities in the United Kingdom also appointed a liquidator to wind up those aspects of the fraud occurring there. The U.K.-based accounting firm Baker Tilly was named as liquidator, a position roughly comparable to the U.S. receiver. Baker Tilly was also appointed bankruptcy trustee over Gangar and White, individually.

In a move believed the first of its kind, the receiver and liquidator entered into a cooperation agreement sanctioned by their respective courts to promote cooperation, rather than competition, in the recovery of assets. The receiver and accountant worked closely with the U.K. liquidator and their counsel. In addition to regular conference calls, strategy meetings were held on both sides of the Atlantic, paired in several instances with the receiver's court appearances abroad.

After one strategy meeting with the liquidator, Terry and Martin also met with the investigators and lead prosecutor for

“Voodoo mathematics” of the Vavasieur fraud

The following example illustrates why the financial mathematics of Vavasieur could not possibly work. The chart presents the annual rates of return for alternative investments and inflation for the period 1998–2002. As is evident, the highest rate of return during this period was 29.79 percent for small public company stocks.

Total annual rates of return, 1998–2002 ⁵							
Year	Large Company Stocks	Small Company Stocks	Long-Term Corporate Bonds	Long-Term Government Bonds	Intermediate-Term Government Bonds	U.S. Treasury Bills	Inflation
1998	28.58	-7.31	10.76	13.06	10.21	4.86	1.61
1999	21.04	29.79	-7.45	-8.96	-1.77	4.68	2.68
2000	-9.11	-3.59	12.87	21.28	12.59	5.89	3.39
2001	-11.88	22.77	10.65	3.7	7.62	3.83	1.55
2002	-22.10	-13.28	16.33	17.84	12.93	1.65	2.38

Investors participating in the Vavasieur fraud were promised a 70 percent annual rate of return. Assuming that an investor invested \$100,000 in the fund for a period of one year, if the investor redeemed the investment at maturity, he should have received \$170,000 (\$100,000 in principal plus \$70,000 in interest).

However, if the Vavasieur fund actually paid out \$170,000 to this investor at maturity, and assuming Vavasieur had actually invested the \$100,000 in the market at the highest available rate of return, 29.79 percent, then *the Vavasieur fund would have lost \$30,981* (\$130,981–\$100,000) on each transaction of this type.

	Vavasieur
Present value of principal invested	\$100,000
Term in years	1
Vavasieur “guaranteed” rate of return	70 percent
Future value of funds due investor	\$170,000

	Market
Future value of funds due investor	\$170,000
Term in years	1
Highest actual market rate of return	29.79 percent
Present value of principal that would be required to realize \$170,000	\$130,981

the U.K. criminal actions in a secret location behind walls and gates to share information. The U.K. police were able to demonstrate a portion of the electronic information recovered in a raid on “the Bunker” — a secret apartment where Gangar and White maintained their computers and records for the fraud.

Postscript

Terrence Lee Dowdell, considered the mastermind of the Vavasieur scheme, pled guilty to securities fraud and wire-fraud, and was sentenced on July 21, 2004, to a 15-year prison term.

Shinder Singh Gangar and Allen White, partners in Dobb White & Co., were convicted in the United Kingdom of conspiracy to defraud and conspiracy to corrupt, and were each sentenced on February 22, 2008, to a seven-and-a-half-year prison term.

The collective efforts of the SEC, U.S. Federal Bureau of Investigation, receiver and forensic accountant resulted in the recovery of approximately \$38 million in stolen funds. Based on the review of the submitted and allowed claims, the Vavasieur investors participating in the distribution will receive approximately 68 percent of their original principal investment. The receivership is currently in the process of making the final distribution to investors. □

1. “Fraud Examiners Manual” (Austin, TX: Association of Certified Fraud Examiners, 1998, rev. 2001), 1.1740.
2. *United States Attorney’s Bulletin*, March 2002: 11. Joel E. Leising and Michael McGarry, “Prime Bank/High Yield Investment Schemes”
3. Michael Maiello, “Thieves Don’t Quit,” *Forbes*, June 9, 2005: 150.
4. *Securities and Exchange Commission v. Dowdell et al.*, Case No. 3:01cv00116 (W.D. Va.).
5. James Licato, ed., *Ibbotson Stocks, Bonds, Bills and Inflation Valuation Edition 2003 Yearbook* (Chicago: Ibbotson Associates, 2003).



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Roy M. Terry Jr., Esq., is an attorney with DuretteBradshaw, PLC, in Richmond, and chairs the firm’s bankruptcy practice group. He is a Chapter 7 Panel Trustee of the U.S. Bankruptcy Court for the Eastern District of Virginia, Richmond Division. He was appointed by the U.S. District Court as the receiver in SEC v. Vavasieur Corp. Contact him at rdurette@bradshaw.com or (804) 775-6948.

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